March 11, 2009

Mary Rupp, Secretary of the Board,
National Credit Union Administration
1775 Duke Street
Alexandria, Virginia 22314-3428

Subject: Comments on Advanced Notice of Proposed Rulemaking for Part 704"

Dear Ms. Rupp;

These comments represent the consensus views of a joint task force representing the Michigan Credit Union League. This comment letter is provided by the Michigan Credit Union League.

The key summary points that the task force offers to the NCUA include the following:

1. Many of the ANPR questions were not deemed relevant because the inference behind the questions seems to be that the Corporate Credit Union System is badly flawed, thus requiring significant restructuring of charters, powers, investment authority, capital requirements, fields of membership, risk management and governance. The task force does not agree with that premise.

2. The task force does acknowledge that the serious stress on the corporate credit union system is in large part due to poor management and inadequate regulatory oversight, especially in those instances where concentration risk associated with mortgage-backed securities was a major contributor to losses. It is also understood that significant economic circumstances (i.e., the meltdown of the housing market), created significant challenges for both effective management and regulatory oversight. Nonetheless, both failed in their respective duties.

3. The task force does wish to comment in four areas that should require immediate action by both the corporate themselves as well as the NCUA. These include investment authority changes, capital issues, improved regulatory oversight and governance issues. All of these areas are intertwined and one cannot be addressed without also addressing the other three. The other questions in the ANPR dealing with field of membership, charter types, types of services and powers are all largely irrelevant and even inappropriate as the NCUA seeks to find ways to mitigate the current risks to the deposit insurance fund and to the credit union community.

4. The task force also wishes to comment on other issues not included in the ANPR. These include: the possible use of government funds to provide a backstop for the NCUSIF, ways to reduce costs for natural person credit unions' deposit insurance and lobbying/public relations issues.

The summary recommendations pertaining to the above four areas suggest that the NCUA should immediately improve its regulatory oversight and expertise pertaining to the corporate credit unions, even if this entails the hiring of outside consultants with greater expertise related to sophisticated investment management. This outside assistance should not be a periodic, after-the-fact decision, but rather a permanent solution that assures adequate oversight in the future.

With regard to investment authority and management, concentration risk appears to be the primary problem. Management failed to mitigate risk exposure due to a heavy concentration in mortgage-backed and asset-backed securities and the NCUA failed to effectively monitor this concentration risk. Improved capital standards are needed for all corporate, especially the U.S. Central FCU that will more appropriately match required capital levels to the risk of the assets held by each institution.

One the issue of governance, a mix of unpaid directors should include representatives from both corporate and natural person credit unions on the U.S. Central Board. All directors should be required to have significant expertise directly related to the operations of U.S. Central, or at a minimum, be well-versed in the fundamental purpose, business model and risk factors associated with the operation. All corporate credit unions should be required to have bylaw provisions that address these governance needs. All directors should be elected at-large as opposed to forcing representation by any asset-size class or geographic region. Expertise should trump "representation" issues given the risks to the deposit insurance fund and the credit union community.

The task force recommends that the NCUA and the credit union movement should seek funds from the federal government, via the Treasury Department to be used as a "backstop" for the NCUSIF but not for direct capital infusion into either corporate credit unions or natural person credit unions. Rather, these funds should be used as a "line of credit", to be used, only if needed in the event of catastrophic circumstances.

The task force also strongly urges the NCUA to support provisions in H.B. 786 that will allow up to five years to restore the NCUSIF capital ratio to the statutory 1.2 percent level. Once this authority is obtained, the task force urges the NCUA Board to move with haste to reduce the premium assessment imposed on credit unions in January in LTCU No. 09-CU-02. Given the current economic climate, the NCUA should allow credit unions to spread this expense out over the maximum, permissible timeframe (i.e., 5 years). The task force also encourages the use of CLF funds for direct access by corporate credit unions and as a resource for mitigating the cost exposure for natural person credit unions.

The task force also strongly encourages transparent communication with the credit union industry regarding the calculation methodology associated with the newly-imposed deposit insurance premiums associated with corporate credit union deposits. Collaboration with the industry and outside consultants should be used to assure that the premium assessment is fair and reasonable given the unprecedented nature of the assessment.

NCUA is also encouraged to lobby the Federal Accounting Standards Board and/or Congress for greater relief on “mark-to-market” accounting. Concurrently, the NCUA should consider implementing temporary “regulatory accounting principles” that would allow the U.S. Central and other corporate credit unions to temporarily operate with capital below GAAP standards but within RAP standards that would account for the “reasonable” value of the mortgage-backed investments during the current frozen credit market environment.

Finally, the NCUA is encouraged to collaborate with credit union trade associations on both lobbying tactics and public relations efforts in order to avoid unintended consequences that would adversely affect the credit union charter or the current regulatory structure. It is understood that in many instances, the NCUA needs to be completely independent on these issues. However, wherever possible, the agency should look to coordinate with industry trade associations in order to achieve a consistent lobbying and public relations message. Public trust in credit unions, the credit union industry’s trust in corporate credit unions and the perception of both credit unions and the NCUA by Congress are all critical factors in the current environment. A well-managed public relations strategy for managing these critical communications may also require assistance from outside consultants.

Detailed Recommendations

In order to provide further detail for the above summary recommendations, the following, more detailed recommendations are provided.

1. **Investment Authority –** Selected Corporate Data for 11/30/08 reveals that corporate credit unions in aggregate held $65.5 billion in investments with $25.5 billion held in U.S. Central. The combined concentration in private, mortgage-backed securities was $34.4 billion or approximately 52 percent of all investments. Asset-backed securities were $23.9 billion or approximately 36.5 percent of all investments.

   The concentration of investments by individual corporate, U.S. Central and the corporate credit unions collectively, in private mortgage-backed securities seems to violate very simple investment principles related to diversification risk, especially sector risk.

2. While investment powers may be appropriate in their current form, from a regulatory oversight perspective, the NCUA has failed in its role to assure that these institutions are adequately managing their concentration risk by sector or investment type. The heavy exposure to stress in the housing market could have been mitigated by a simple requirement that these investments be spread among other asset classes (i.e., corporate bonds, non-mortgage debt, etc.).

   The NCUA should limit this concentration risk either by statutory changes or by regulation, taking into consideration the broader concentration risk that the entire credit union industry holds by virtue of credit unions' concentration in mortgage loans and related assets.

   The NCUA should also look to limit and/or prohibit other high-risk and complex investments (i.e., net interest margin bonds, CDO tranches, commercial mortgage-backed bonds, etc.)

3. **Capital Issues –** NCUA should look to apply some form of risk-based capital standards to the U.S. Central and corporate credit unions that would require higher levels of capital associated with riskier investment portfolios, the use of arbitrage investing, etc. Those corporate who invest more prudently should be allowed to operate with lower capital requirements.

   The NCUA should consider the application of revised BASEL capital standards to the corporate credit union system.

4. **Improved Regulatory Oversight –** The NCUA failed to provide adequate oversight for the corporate credit union system, especially related to concentration risk issues noted above.

   The NCUA should move quickly to hire or retain specialized expertise for examining and regulating corporate credit unions that operate with complex investment authority. Existing specialized examiners should be evaluated and be either replaced or upgraded with additional skills. The NCUA should also consider using a permanent outside consultant for periodic examination of corporate credit union investment portfolios. The "after-the-fact" hiring of PIMCO is not a good example of appropriate regulation and supervision. Proactive, ongoing expertise is needed in order to avoid future capital impairments.

   The NCUA might also consider requiring a special outside certification of corporate credit union investment portfolios similar to the requirement of SAS 70 certifications for data processing security risks.

5. **Governance Reforms –** The task force believes that the structure of boards of directors should be left to the respective memberships of each corporate credit union as covered in their bylaws. However, in the case of the U.S. Central, the USC should have a board of directors comprised of executives from both natural person credit unions and corporate credit unions exclusively.

   Elections should not be dictated by asset –size class or geographic region. The membership should elect highly-qualified representatives who understand the U.S. Central's business, especially investment dynamics. All directors should be elected "at-large". Outside board members could be considered as long as they are qualified.

   The NCUA should consider imposing additional transparency requirements on at least the U.S. Central Board that would pertain to financial statement transparency, risk composition of investments, director qualifications, management of directors' conflicts of interest, certification of financial statements and investment portfolio, CEO accountability, etc. (i.e., Sarbanes/Oxley).

6. **Use of Federal Assistance –** The task force recognizes the reputation risk and political challenges associated with accessing federal funds for strengthening the NCUSIF. This option should only be used at a last-resort, based on NCUA's risk assessment related to corporate credit unions and the broader industry. However, NCUA should seek limited authority for using Treasury funds as a last-resort "backstop" for the NCUSIF. These funds would be repaid by the NCUSIF as the economy improves.

   Credit unions should also have access to any federal program (TARP or otherwise), that allows credit unions to sell distressed assets (mortgage loans, mortgage-backed securities, etc.) in order to take distressed assets off of credit union balance sheets (including corporate credit unions), with the understanding that this would be done in such a way that would insulate taxpayers from loss exposure due to the likelihood of long-term appreciation in those assets.

7. **Natural Person Credit Union Cost Considerations –** The NCUA is encouraged to actively support the passage of H.B. 786 that will expand the NCUSIF's borrowing authority and the timeframe (from current year to 5 years), with which the NCUA Board can restore the NCUSIF capital level to 1.20 percent. The NCUA should then move with haste to allow credit unions to reduce the premium assessed in LTCU No. 09-CU-02 by allowing credit unions to spread the premium over the maximum timeframe permitted by law. This is especially important given the possibility of additional losses to the NCUSIF and the

extreme stress experienced by credit unions due to other economic factors during this deep recession. Credit unions that wish to expense the whole premium in one calendar year should be allowed to do so however.

The NCUA should use every means possible to allow corporate credit unions to access CLF funds directly and to use CLF funds as a backstop for NCUSIF risks.

The NCUA is also encouraged to seek authority to give corporate credit unions and natural person credit unions relief from the current “mark-to-market” accounting requirements where 1) assets are held to maturity, and 2) no active market exists for value determination. In the absence of FASB guidance in this regard, the NCUA should consider allowing an alternative set of regulatory accounting principles (RAP) on a temporary basis that would allow corporate credit unions to operate with lower capital levels until these investment markets stabilize.

Regards**,**

David Adams
CEO
Michigan Credit Union League & Affiliates (www.mcul.org)
CUcorp, CU Village, HRN

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